

THE STATE OF NEW HAMPSHIRE

MERRIMACK, SS.

SUPERIOR COURT

The State of New Hampshire

v.

Philip Morris USA, R.J Reynolds, Inc. and
Lorillard Tobacco Company

PETITION FOR EXPEDITED DECLARATORY ORDER

NOW COMES the State of New Hampshire (the “State”) by and through Attorney General Kelly A. Ayotte, and prays this Court declare that the State of New Hampshire has diligently enforced RSA 541-C, the Non-Participating Manufacturers Act. In support whereof, the State says as follows:

PARTIES

1. Plaintiff, State of New Hampshire, has entered into the tobacco Master Settlement Agreement (“MSA”) and thus is a Settling State as defined in the agreement. Attorney General Kelly A. Ayotte is authorized to bring this action against defendants pursuant to section VII (c)(1) of the MSA, which authorizes any Settling State to bring an action for a declaration construing any term therein ("Declaratory Order") with respect to disputes, alleged violations or alleged breaches within such Settling State.

2. Defendant Philip Morris USA, is a tobacco product manufacturer headquartered at 6601 West Broad Street, Richmond, Virginia 23230. Defendant R.J. Reynolds Tobacco Company, is a tobacco product manufacturer located at 401 North Main Street, Winston-Salem, North Carolina 27102. Defendant Lorillard Tobacco Company is a tobacco products

manufacturer located at 714 Green Valley Road, P.O. Box 10529, Greensboro, North Carolina 27404. Philip Morris USA, R.J. Reynolds Tobacco Company and Lorillard Tobacco Company are Original Participating Manufacturers ("OPMs"), as defined in section II (hh) of the MSA.

JURISDICTION AND VENUE

3. This Court has exclusive jurisdiction over this action for the purposes of implementing and enforcing the MSA in New Hampshire. (MSA, § VII(a)(2), entered as an order by this Court on November 23, 1998, docket number 97-E-0165).

4. Each and every defendant consented to this Court's jurisdiction when it joined the MSA. (*Id.*, § VII(a)(1)).

NOTICE

5. The State issued notice of its intention to bring this action on March 3, 2006, at least thirty days prior to this filing, as required by section VII (c)(2) of the MSA.

FACTUAL ALLEGATIONS

6. In November 1998, the Attorneys General of 46 states, the District of Columbia, the Commonwealth of Puerto Rico and four territories ("Settling States") entered into the MSA with the OPMs. In return for a release by the Settling States of certain of their past, present and future claims, the OPMs promised, among other things: (1) to make certain settlement payments to the Settling States, including annual payments in perpetuity; (2) to fund a national foundation devoted to educating the public about the dangers of tobacco use; and (3) to adhere to certain restrictions on their advertising, marketing and other practices.

7. The MSA permits other cigarette manufacturers to join the settlement agreement, and to date, over 40 such manufacturers have done so. Identified as Subsequent Participating

Manufacturers (“SPMs”), these manufacturers must agree to make annual settlement payments to the Settling States and to adhere to the same restrictions on their advertising, marketing and other practices as the OPMs. The OPMs and SPMs together are referred to as Participating Manufacturers, or “PMs”.

8. Many tobacco product manufacturers chose not to join the MSA. Those manufacturers are referred to as “Non-Participating Manufacturers” or “NPMs.”

9. The payment obligations described above caused the PMs to raise the price of their cigarettes sold in the State. This put the PMs at a competitive disadvantage compared to the NPMs. To lessen the effect of this disadvantage, the Settling States agreed to enact Qualifying Statutes. A “Qualifying Statute” is defined in the MSA as one that “effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers . . . as a result of the provisions of [the MSA].”

10. New Hampshire’s Qualifying Statute is R.S.A. 541-C, and it requires every NPM doing business in New Hampshire to establish an escrow account into which it is to pay a certain amount, as described in the statute, for each cigarette the NPM sells into New Hampshire.

11. The MSA establishes incentives for the Settling States to both enact and enforce Qualifying Statutes. Specifically, failure to enact or enforce a Qualifying Statute can result in adjustments of the payment to the states made pursuant to the MSA.

12. It is just this sort of adjustment that is at the root of this action. The State brings this action pursuant to section VII of the MSA for a Declaratory Order that the State’s Allocated Payment received in 2004 under the MSA is not subject to being reduced by the Non-Participating Manufacturer Adjustment for 2003 (“2003 NPM Adjustment”), one of

several potential adjustments to the annual payments due to the Settling States under the MSA, because the State “diligently enforced” N.H. R.S.A. 541-C, during the entire calendar year of 2003.

13. The MSA establishes the NPM Adjustment as a means of reducing the amount a PM will need to pay into the MSA Settlement Fund. The NPM Adjustment was conceived as an incentive to the Settling States to diligently enforce their Qualifying Statutes, and applies when three factors are present. First, the PMs must lose 2% or more of their pre-1997 market share to the NPMs. Second, a nationally-recognized economic analysis firm must determine the MSA imposes a competitive disadvantage on the PMs, and that this competitive disadvantage was a “significant factor” in the market share shift. If the economic analysis firm determines that the MSA is a “significant factor” in the market share loss, applicability of the NPM Adjustment to any Settling State’s MSA payments depends upon the third factor. Specifically, the MSA exempts a state from a reduction in payments if that state meets two conditions: first, that the state has enacted a “Qualifying Statute” as defined in the MSA, and second, that the state has diligently enforced the Qualifying Statute during the year in question. MSA § IX(d)(2)(b).

14. As noted above, RSA 541-C, New Hampshire’s NPM statute, is such a Qualifying Statute. RSA 541-C has been in full force and effect since its enactment in 1999, and was amended in 2004 to strengthen its effectiveness. The State has diligently enforced RSA 541-C since its enactment, including specifically the year 2003, the period in question. Thus, the State of New Hampshire is exempt from a reduction in its payments under the MSA.

15. Until March 28, 2006, the so-called "significant factor" determination for 2003 - the second factor described above in Paragraph 13 - had not been fulfilled. However, late in

2005, the Settling States and the OPMs engaged the Brattle Group, a nationally known economic analysis firm, to establish whether the provisions of the MSA constituted a “significant factor” in a market share shift to the NPMs that occurred in the year 2003.

16. On March 28, 2006, the Brattle Group concluded that the MSA was a “significant factor” in that market share shift. Now some of the Participating Manufacturers contend that they are entitled to the NPM Adjustment, and have lessened their MSA payments by either withholding the 2003 NPM Adjustment from their MSA settlement payment due April 17, 2006, or by placing it into a disputed payments account. Because the payments to the states are distributed on a proportional basis, this withholding or diversion of MSA payments reduces each Settling State’s MSA payment, effectively causing all the Settling States to bear the burden of the MSA Adjustment.

17. These PMs’ position ignores the specific language of the MSA. As noted above, until a Settling State is shown to have failed to diligently enforce its Qualifying Statute, that Settling State is exempt from any payment reduction arising out of an NPM Adjustment. To date, no Settling State has yet been shown to have failed to “diligently enforce” its Qualifying Statute. Thus New Hampshire, along with every other Settling State, should receive its full payment. Withholding or diverting any payments into a disputed payments account results in the MSA payments to all Settling States being reduced proportionately across the board. On April 17, 2006, the date upon which all payments into the MSA Settlement Fund are due, and citing the NPM Adjustment, Defendants R.J. Reynolds and Lorillard diverted \$755 million into a Disputed Payments Account. This action, taken in the absence of any determination by this Court that New Hampshire has failed to diligently enforce its Qualifying Statute, results in the immediate diminution of New Hampshire’s payment by over \$5 million.

18. New Hampshire has diligently enforced its Qualifying Statute. R.S.A. 541-C was enacted in 1999 and became effective that year. Since before 2003, the New Hampshire Department of Justice ("DOJ") has worked together with the New Hampshire Department of Revenue Administration to identify all wholesale sellers of tobacco products and to gather data from these wholesalers to determine how many cigarettes or cigarette equivalents are sold on an annual basis, and how many of these are the products of NPMs. Since before 2003, the DOJ has identified all NPMs who sell their products into the State to ensure that they are compliant with our Qualifying Statute, and routinely has filed suit against those who are not. In 2003, the DOJ worked to amend the Qualifying Statute to correct provisions thereof which hindered efficient enforcement. Since before 2003, DOJ personnel have routinely attended conferences and consulted with other tobacco enforcement personnel from around the United States to ensure that New Hampshire's enforcement of its Qualifying Statute conforms with the best practices for doing so nationwide.

DECLARATORY ORDER

19. The State restates and re-alleges all the previous claims and allegations as if fully set forth herein.

20. The State has taken all necessary steps to enforce its Qualifying Statute, including for the entire year 2003. The State has established comprehensive methods for identifying NPM sales in the State and for ensuring that those sales are made in full compliance with New Hampshire's Qualifying Statute. Non-compliant NPMs routinely and specifically in the year 2003 have been sued and banned from doing business in the State.

21. New Hampshire is seeking an order that it has diligently enforced its Qualifying Statute and is entitled to its full payment pursuant to the MSA for the year 2003.

22. New Hampshire is seeking an order that it is entitled to immediate payment of its share of all funds that have been withheld or not been paid to the State.

PRAYER FOR RELIEF

WHEREFORE, the State prays this Honorable Court:

A. Schedule a hearing within ten (10) days of the issuance of Orders of Notice for the defendants R.J. Reynolds and Lorillard show cause as to why the State has not been paid its full payment pursuant to the MSA.

B. Enter a Declaratory Order pursuant to section VII of the MSA, declaring that the State is not subject to an NPM Adjustment for the year 2003, and that defendants are not entitled to undertake any action which would result in New Hampshire receiving any less than its fully allotted payment as set out in the MSA and due on April 17, 2006 - or in the future - on the basis that the State allegedly did not diligently enforce its Qualifying Statute during the entire calendar year of 2003.

C. Order that Pricewaterhouse Coopers, the Independent Auditor responsible for distribution to the Settling States of funds paid by the PMs, release from the Disputed Payments Account and distribute to the State the balance of the NPM Adjustment withheld by the PMs and owed to the State.

D. Award the State its costs and attorney fees incurred in this action.

E. Schedule a hearing on an expedited basis due to the potential impact the withholding on April 17 will have on the fiscal and public health of the State.

F. Grant any such other relief as it just and proper.

Respectfully submitted,

THE STATE OF NEW HAMPSHIRE

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